REPORT OF THE AUDITOR-GENERAL TO THE KWAZULU-NATAL PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF UMHLABUYALINGANA MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of the Umhlabuyalingana Municipality which comprise the balance sheet as at 30 June 2008, income statement, cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), and the Division of Revenue Act, 2007 (Act No. 1 of 2007 (DoRA). This responsibility includes:

    - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
    - selecting and applying appropriate accounting policies
    - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.

4. I conducted my audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance on whether the financial statements are free from material misstatement.

5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk

assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

6. An audit also includes evaluating the:
   - appropriateness of accounting policies used
   - reasonableness of accounting estimates made by management
   - overall presentation of the financial statements.
7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis of accounting

8. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Basis for qualified opinion

Debtors

9. The financial statements reflect a Value Added Tax (VAT) receivable amount of R5 220 268 in Note 7. This receivable represents claims for VAT refunds in respect of a number of VAT periods, including R3 836 301 relating to prior years. The municipality is currently undergoing a VAT audit by South African Revenue Services (SARS). Since we have not been provided with apportionment confirmation of the claim receivable, the claim of R3 836 301 relating to prior year is considered to be irrecoverable and has been recorded on the schedule of unrecorded audit differences.

   As a result VAT debtors are overstated and expenditure understated by R3 836 301.

Creditors

10. The amount in respect of Pay As You Earn (PAYE) due for the year to June 2008 reflected on the statement from SARS was R1 342 407. This excludes penalties and interest of R127 780 and R98 243 respectively not raised and recorded in the books of the municipality. The municipality paid R504 060 of this liability. However, the outstanding PAYE liability was recorded in the financial statements as R702 836, which is understated by R135 511 (R361 534 including penalties and interest).

    As a result creditors are understated and expenditure overstated by R135 511 (R361 534 including interest and penalties).

Qualified opinion

11. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, the financial statements of the Umhlabuyalingana Municipality as at 30 June 2008 and its financial performance and cash flows for the year then ended have been prepared, in all material respects, in accordance with the basis of accounting as set out in accounting policy note 1 and in the manner required by the MFMA and DORA.

Emphasis of matters

I draw attention to the following matters:

Going concern

12. With regards to concomitant assets, Umhlabuyalingana Municipality had an accumulated operating deficit of R8 916 893 at 30 June 2008 and as at that date the entity had a cash overdraft per the financial statements of R1 055 748. During the audit of funds, reserves and provisions, it was noted that the funds, reserves and provisions per the financial statements amounted to R13 087 222. Consequently, there is a shortfall of R14 142 970 in the financing of the funds, reserves, creditors and provisions.

    In addition, the municipality is unable to meet all its daily current creditor commitments and payments. This is due to the erosion of its capital base over the last two years and resulting in creditors being financed through a short term overdraft.

Unauthorised expenditure

13. The municipality incurred unauthorized expenditure of R2,5 million, being conditional capital grant funding utilised for operating expenditure. The unauthorised expenditure is in terms of section 1 of the MFMA – Definitions (Unauthorised expenditure (f) – a grant by the municipality otherwise than in accordance with this Act).

14. Unauthorised expenditure of R555 498 was incurred, being the over-expenditure of repairs and maintenance and leave encashment budgets. The over-expenditure was not taken to council for ratification, as required by section 29(3) of the MFMA. This is in terms of section 1 of the MFMA – Definitions (Unauthorised expenditure – overspending of the total amount appropriated for a vote in the approved budget).

OTHER MATTERS

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Internal controls

15. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the inefficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In certain instances deficiencies exist in more than one internal control component.

Reporting item	Control environment	Risk assessment	Control activities	Information and communication	Monitoring
Debtors			✓		
Creditors			✓		

Control environment: establishes the foundation for the internal control system by providing fundamental discipline and structure for financial reporting.

Risk assessment: involves the identification and analysis by management of relevant financial reporting risks to achieve predetermined financial reporting objectives.

Control activities: policies, procedures and practices that ensure that management's financial reporting objectives are achieved and financial reporting risk mitigation strategies are carried out.

Information and communication: supports all other control components by communicating control responsibilities for financial reporting to employees and by providing financial reporting information in a form and time frame that allows people to carry out their financial reporting duties.

Monitoring: covers external oversight of internal controls over financial reporting by management or other parties outside the process; or the application of independent methodologies, like customised procedures or standard checklists, by employees within a process.

Non-compliance with applicable legislation

Municipal Finance Management Act

16. In accordance with Section 29 (3) of the MFMA No. 56 of 2003, an adjustment budget was not passed within 60 days after the incurring of unauthorised expenditure, in order for the council to ratify the expenditure.

17. MFMA circular no. 34: section 1 was not adhered to as contracts awarded in excess of R100 000 were not reported to National Treasury as required.

Division of Revenue Act

18. In accordance with section 71 of the DORA for the period June 2008, the accounting officer of the municipality did not submit to national treasury, the electronic or signed returns on its conditional grant spending in terms of section 31(2).

Supply chain management

19. In accordance with section 12(1)(a) the municipality did not follow the required range of supply chain management (SCM) processes to include tenders, quotations, auctions, and other types of competitive bidding.

Matters of governance

20. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.	✓	
• The audit committee operates in accordance with approved written terms of reference.	✓	
• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	✓	
Internal audit		
• The municipality had an internal audit function in operation throughout the financial year.	✓	
• The internal audit function operates in terms of an approved internal audit plan.		✓
• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.		✓
Other matters of governance		
• The annual financial statements were submitted for audit as per the legislated deadlines (section 126 of the MFMA).	✓	
• The annual report was submitted to the auditor for consideration prior to the date of the auditor's report.		✓
• The financial statements submitted for audit were not subject to any material amendments resulting from the audit.		✓
• No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information		✓

and/or the unavailability of senior management.		
• The prior year's external audit recommendations have been substantially implemented.		✓
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
• The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 30 October 2007.		✓
• The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP.		N/A
• The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008.		✓

Unaudited supplementary schedules

21. The supplementary information set out in appendix A to F does not form part of the financial statements and is presented as additional information. I have not audited this schedule and accordingly I do not express an opinion thereon.

OTHER REPORTING RESPONSIBILITIES

REPORT ON PERFORMANCE INFORMATION

22. I was engaged to review the performance information.

Responsibility of the accounting officer for the performance information

23. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

24. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the Municipal Systems Act No.32 of 2000.

25. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

26. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (performance information)

Non-compliance with regulatory requirements

27. In accordance with section 38 (a) of the MSA, the municipality could not provide a detailed description of the process followed for the performance system. Consequently it could not be ascertained whether the municipality established a performance information system that is:
    - commensurate with its resources,
    - best suited to its circumstances, and
    - in line with the priorities, objectives, indicators and targets contained in its integrated development plan.

28. In accordance with section 38 (c) of the MSA, the municipality could not provide a portfolio of evidence to support the final performance ratings to provide assurance that the municipality administered its affairs in an economical, effective, efficient and accountable manner.

29. No performance information report was presented for an annual audit in terms of section 45(b) of the MSA by the date of my report.

APPRECIATION

30. The assistance rendered by the staff of the Umhlabuyalingana Municipality during the audit is sincerely appreciated.

Pietermaritzburg

28 November 2008

AUDITOR-GENERAL